IN THE

Supreme Court of the United States

October Term, 1944

No. 203

MANUFACTURERS' FINANCE COMPANY,
Petitioner

V.

DAVE MARKS, Trustee in Bankruptcy of
BELMONT CANDY COMPANY, Bankrupt,
Respondent.

BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR CERTIORARI.

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To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

The Statement of the Case and the questions presented in the petition for certiorari entirely fail to show the real facts and the real questions involved. In order to rectify this situation it is necessary to state certain vital and important facts entirely omitted in the petition.

Sometime prior to July 1, 1932, the petitioner, the Manufacturers' Finance Company, had been purchas-

ing assigned accounts of the bankrupt (Respondent), and no question is raised as to the legality of these transactions. About July 1, 1932, there was a diversion of funds by the bankrupt, and thereupon the petitioner placed E. L. Bradley, an auditor, in complete charge of the bankrupt's business in Memphis, and proceeded from that date to operate the business for its own exclusive benefit. After July 1 until October 6, 1932, Bradley had absolute control of the bankrupt's business (R. 229, 231, 281, 282, 284). Bradley controlled the credits, the accounts, the collections and all remittances to petitioner in Chicago.

Every single account created by the bankrupt was controlled by Bradley and sent to Chicago and every single collection on these accounts was personally handled by Bradley and remitted in kind to petitioner. (R. 107, 177, 187, 188.)

On October 6, 1932, the petitioner discontinued doing business with the bankrupt and thereafter all collections were made directly by it and the bankrupt had absolutely no knowledge of the accounts collected, the amounts paid or those that remained outstanding (R. 188). The business of the bankrupt from July 1, 1932, to October 6, 1932, was operated absolutely and exclusively for the benefit of petitioner. Without discussing the numerous facts and circumstances surrounding this situation we summarize it by stating that the Referee in Bankruptcy (R. 230), and the District Court in nine different places (R. 265 to 292) held that all of these transactions were fraudulent.

The United States Circuit Court of Appeals for the Sixth Circuit in its opinion holds that the verbal agree-

ment of July 1, 1932, was made in contemplation of insolvency and constituted a fraudulent preference (R. 340). We have a case of the Referee, the District Court and the Court of Appeals all concurring in a find of fact that the petitioner was guilty of creating a fraudulent preference, in that it transferred to itself all of the liquid assets of the bankrupt, obviously resulting in hindering and delaying its other creditors (R. 340, 341).

In its petition for certiorari the petitioner states that the decree of the District Court was based on an "alleged preference." This is not a correct statement. The three courts mentioned have held that the decree is based on a proven fraudulent preference, hindering and delaying creditors. There is no surmise or presumption about this and we submit that this Court will not examine into the record to ascertain the correctness of these facts. The case, therefore, presented is one of a fraudulent preference, concurred in by three separate courts and we submit that this Court will accept these findings of fact as final.

The law on this subject is thoroughly settled.

In re Willoughby, et al., Berry v. Austin, et al., 95 Fed. (2d), 932 (6th Cir.).
Fruehauf Trailer Co. v. Bridge, 84 Fed. (2d), 660.
Atlanta Knitting Mills v. Nathanson Bros. Co., 64 Fed. (2d), 912.
Dickinson v. O. & W. Thum Co., 8 Fed. (2d), 570.
Roberts v. Southern Surety Company, 33 Fed. (2d), 501.

The sole issue, therefore, that is presented in the petition for certiorari is based on a fraudulent preference,

deliberately conceived and entered into by the petitioner, resulting in great benefit to itself and hindering and delaying other creditors.

We submit that the opinion of the Court of Appeals on this question is final and conclusive. The Court says:

> "The burden was on the Trustee to establish every element of a preference (Cainwright v. General Finance Corp., 123 Fed (2d) 98 (C. C. A. 7); First National Bank of Negaunce v. Fox, 111 Fed. (2d) 810 (C. C. A. 6), and this burden he has sustained."

The petition for certiorari absolutely ignores and omits this all important proposition of fact and law.

This is not a case of ordinary assignments of accounts where the collections were made by the assignor and in turn remitted to the assignee. On the contrary, the assignor had no control with either the creation of the accounts, their assignment or the collection of their proceeds. All of this was done by Bradley, the agent of the petitioner located in respondent's plant in Memphis. The issues presented, therefore, are not those set forth at page 5 of the petition.

QUESTION AT ISSUE

Where a finance company obtains a fraudulent preference by taking possession of the business of a bankrupt, operates it for its own benefit through its own agent, and all collections are made through this agent directly to it, and it has the absolute and exclusive knowledge of all accounts paid, the burden of proof is on the finance company to disclose the actual facts as to payments of accounts, and its failure or refusal to

do so is and of itself fraud on the other creditors, and a presumption arises against the legitimacy of such payments.

The petition should be denied because it does not present any issue within the scope of the statute authorizing the granting of a petition for certiorari.

The reasons relied on in the petition are (1) that there is a conflict between this decision and other decisions of Circuit Courts of Appeals; (2) that an important question of Federal law has been decided contrary to the decisions of this Court and is against the established authority; and (3) that the Court departed from the usual course of jurisdictional proceedings so as to call for an exercise by this Court of its power of supervision.

We will answer each of these propositions in the same order.

ARGUMENT

No Conflict of Authorities

The decision in this case is not in conflict with the decisions in the cases of *Israel v. Woodruff*, 299 Fed. 454 (C. C. A. 2); *Brown v. Christman*, 126 Fed. (2d), 625; *Stennick v. Jones*, 282 Fed., 161, for the reason that the facts in the instant case are entirely different.

We admit, and the Court of Appeals, held that the Trustees must establish every element of a preference, and this he has done (R. 340, 341).

In the case of Israel v. Woodruff there was no question of the fraudulent preference involved, nor does that case show that the actual facts with reference to payment of the accounts, were exclusively in the possession of the creditor; on the contrary, these facts were all in the exclusive possession of the bankrupt.

The case of Brown v. Christman, et al, if it is an authority for anything, sustains the Trustee's contention, because in that case the administratrix of an estate set up the defense that where money was deposited from rents collected by the deceased that the burden was on the owners of the property to show that the money in the hands of the administratrix was a part of the rent collected. Manifestly this was not sound, because the administratrix had in her possession all of the information with reference to these accounts and it was up to her to account for the rents collected. When it is shown that information is exclusively in the hands of one party to litigation, the law is well settled that the burden of proof is upon this party to disclose all of the facts.

The case of Stennick v. Jones can be easily distinguished because the defendant in that case took possession of certain property under a perfectly legal and valid contract in a perfectly legal and valid manner. There was no question of fraud or a fraudulent preference involved and, therefore, the case is not in point.

A complete answer to these cases is the finding of fact by the District Court and the Court of Appeals that the petitioner obtained a fraudulent preference and had in its hands the necessary proof to show what was the actual result of such a fraud.

In its final analysis, the position of the petitioner is that having created a fraudulent preference by its own acts, with full knowledge of the insolvency of the bankrupt, and having in its possession full information with reference to moneys collected on assigned accounts, it is still not responsible for the results of the fraudulent preference, because the Trustee in Bankruptcy has not shown specifically the source of the collections. We assert that the petitioner having perpetrated a fraud on creditors is now seeking to escape the penalty by the suppression or failure to produce the proof, which it had in its possession.

Fraud works in the dark, and when the results of fraud are in the hands of the fraudulent creditor it does not lie in that creditor's mouth to call on any one for proof.

One of the best analogies to this situation is where an agent collects money belonging to his principal. The burden is on the principal to establish agency and the

right of the agent to make the collections. It is then the duty of the agent to render an accounting for the money collected.

Corpus Juris Secundum, Vol.. 3, Section 164 (b), p. 52, on Agency.
Otero v. Banco de Sonora,
26 Ariz., 356; 225 Pac., 1112.
National Bk. v. Ins. Co.,
104 U. S., 54.
Meacham on Agency, 2nd Edition, Sec. 1344.

There are numerous cases and situations where the burden of evidence shifts, and there are likewise numerous situations where certain facts having been established by the plaintiff, the burden is then on the defendant to exonerate itself.

Equipment Acceptance Corp. v. Arnold Can Manufacturing Co.,
117 Fed (2d), 442 (6th Cir.).

In this case the Court held that where a negotiable instrument is acquired through a defective title the burden is then on the holder to show that it is a holder in due course for a valuable consideration.

Likewise the law imposes this burden of exoneration on the bailee for hire, where goods are delivered to it and the bailee fails to account for them on demand.

In the case of

Commercial Molasses Corp. v. New York Tank & Barge Corp.,
314 U. S., 104; 86 Law Ed. 89,

the Court discussed the question of the burden of proof in case of a loss by a chartered carrier and held that

the burden of proof did not shift technically, but that the burden of explaining the loss was on the carrier. When it did so then it had met its obligation under the law. Of course, the facts are different, but the broad principle of law is stated by the Court as follows:

> "The burden of proof in a litigation, wherever the law has placed it, does not shift with the evidence, and in determining whether petitioner has sustained the burden the question often is, as in this case, what inferences of fact he may summon to his aid. In answering it in this, as in others where breach of duty is the issue, the law takes into account the relative opportunity of the parties to know the fact in issue and to account for the loss which it is alleged is due to the breach. Since the bailee in general is in a better position than the bailor to know the cause of the loss and to show that it was one not involving the bailee's liability, the law lays on him the duty to come forward with the information available to him."

The rule of law applicable, therefore, in this case is the one laid down by the Court of Appeals and is supported by the above cited authorities.

In addition to the foregoing it is well established law that the failure to produce evidence in the possession and control of a party to any litigation raises the presumption that the evidence, if produced, would not be favorable.

Kirby v. Talmage,
160 U. S., 379-383.
20th American Jurisprudence (*Evidence*),
Section 183, p. 188.
Wetmore v. Rymer,
169 U. S., 115; 42 Law Ed., 682.

Standard Oil Co. v. State,
117 Tenn., 618-672.
Moore on Fraudulent Conveyances,
Sec. 15, p. 913.
22 *Corpus Juris,* 111.

This principle of law ties in with and is a part of the broad and fundamental proposition that every party to litigation, especially where that party is guilty of improper conduct, must disclose all the evidence in its possession. Assuming that the Trustee relied on a presumption that the accounts created prior to July 1, 1932, were paid from accounts created after that date, a complete answer to this presumption was in the possession of the petitioner. Instead of going forward with the evidence the petition undertakes to rely on a proposition of law. Having conducted itself so as to hinder, delay and defraud creditors, it now asks this Court to help it out by sanctioning its suppression of evidence. It wishes to take advantage of its improper conduct by refusing to disclose the evidence which was in its possession. This it cannot do and the Court of Appeals held that in view of the conduct of the petitioner that the burden was on it to establish the legitimacy of its reimbursements to itself subsequent to June 30, 1932 (R. 347).

The petitioner absolutely, without the knowledge of the officers of the bankrupt, created a so-called reserve account, designated by the District Court as "arbitrarily and fraudulently set up," which designation is affirmed by the Court of Appeals (R. 345). What accounts are in this reserve no one knows except the petitioner and it does not say. Having created a fraudulent reserve,

without the knowledge of the bankrupt's officials, it was certainly up to it to explain it and the Court of Appeals so held (R. 173, 178). See also

Cliett v. Scott,
102 Fed. (2) 725.

Having created this situation by and through its own agent, and having in its possession all the facts, the burden was on the petitioner to disclose these facts and bring forward the information it had so as to rebut the presumption raised by the undisputed evidence.

The principles of law cited by the petitioner are sound on the facts of those cases, but they are not sound on the facts of this case. The Court of Appeals recognized this proposition and cites in support of its opinion the case of Rossman v. Blunt, 104 Fed. (2d) 877-880, where the rule is laid down as follows:

> "The records of banks are ordinarily kept by its confidential agents and employees, the customers and the public generally not having access to them and on receivership, the receiver becomes their sole custodian.
>
> "The proof on behalf of appellee shows prima facie that the receiver's assets were augmented by the proceeds of the draft. Mammoth Oil Company v. United States, 275 U. S., 13, 14, 52, 48 S. Ct. 1, 72 L. Ed. 137. In such case, all of the veidence adducible upon the question being in the possession of the receiver and not easily attainable by the appellee the burden shifts to him to show that his assetts were not augmented by the proceeds of the draft. Selma, Rome & Dalton Railroad Company v. United States, 139 U. S., 560, 568, 11 S. Ct., 638, 35 L. Ed. 266. The burden of proof rested on the appellee to show that his property had been wrong-

fully mingled with the mass property of the bank, but under the peculiar facts of this case when that was done, the burden of going forward with the evidence shifted to the receiver. Smith v. Mottley, 6 Cir., 150 F 266."

In addition to the foregoing the case of

Brown v. Mars, Inc.,
135 Fed. (2d), 843, 850 (8th Circuit)

in discussing the question of the burden of proof where a suit was filed to enjoin violation of the Emergency Price Control Act of 1942, the Court held that the burden of proof rested on the defendant, Mars, Inc., to show that the maximum prices charged were caused by manufacturing formulae or methods and gives two reasons, the first of which is not applicable. The second reason given is directly in point and furthermore cites all of the Federal cases up to date on this question of burden of proof. The Court says:

"The second reason is that the evidence to prove the existence of and the effect upon product weights of manufacturing methods and of changes in formulae is peculiarly within the knowledge of the manufacturer, United States v. Denver & R. G. R. Co. 191 U. S. 84, 92, 24 S. Ct. 33, L. Ed. 106; Selma, etc., R. C. v. United States 139 U.S. 560, 567, 568, 11 S. Ct. 638, 35 L. Ed. 266; Rossman v. Blunt, 6 Cir., 104 F. 2d 877, 880; Cliett v. Scott, 5 Cir., 102 F. 2d 725; Miller v. Lykes Bros., etc., Co., 5 Cir., 98 F. 2d 185, 186, certiorari denied 305 U. S. 641, 59 S. Ct. 150, 83 L. Ed. 413, Liberty Bell Gold Mining Co. v. Smuggler-Union Mining Co., 8 Cir., 203 F. 795, 804, certiorari denied 231 U. S. 747, 34 S. Ct. 320, 58 L. Ed. 464; The Medea, 9 Cir., 179 F. 781, 786; West v. W. A. McLaughlin & Co.'s Trustee, 6 Cir., 162 F. 124, 128."

It, therefore, results that the so-called conflict with other decisions of courts of appeals does not exist.

II

No Presumption on a Presumption

The next proposition advanced by the petitioner is that the basis of the decision rested on a presumption admittedly unsupported by the record and upon another presumption built on the first resumption. Neither of these propositions is correct nor are they supported by the record. In spite of the ruling of three courts to the contrary, the petitioner makes this extraordinary statement in his argument. See petition pp. 17, 18.

> "It is *admitted* (italics ours) on the record that all of the collections on all accounts during the period from June 30, 1932, to October 6, 1932, were made by the bankrupt and forwarded to petitioner. That was the date after which petitioner purchased no further accounts from bankrupt and several days thereafter petitioner gave notice to the debtors to pay the accounts directly to it."

The collections were not made by the bankrupt but were made by Bradley, the agent of the petitioner, who was in Memphis, and controlled these collections (R. 107, 177, 187, 188). He attended to the assigning of the accounts and he alone had the key to the mail box through which collections were made and he alone forwarded these collections to the petitioner in Chicago. In short, the bankrupt did not make these collections, except in name. The real facts, without dispute, show that the collections were made by the petitioner itself, through Bradley, sent in kind to Chicago and yet the whole argu-

ment of the petitioner is based on the statement that all collections were made by the bankrupt.

We agree that ordinarily a legal presumption arises that all payments made by a bankrupt are valid and the burden is on the Trustee to show to the contrary, but where the Trustee proves a fraudulent scheme to hinder and delay creditors, and further shows that collections or payments were not made by the bankrupt, but made through the agent of the creditor, then this presumption manifestly does not apply.

The case of

Israel v. Woodruff,
299 Fed. 454 (C. C. A. 2)

quoted by the petitioner sustains our proposition exactly, inasmuch as it says:

> "The payments by the bankrupt were consistent with honesty in every part, and the burden was on the appellant to show that payments were not made from the proceeds of the sale of the potatoes."

The payments in this case are not consistent with honesty, because they were not made by the bankrupt, but made by petitioner to itself through Bradley.

If the petitioner made any collections of these accounts it knows it and it mingled the proceeds with all other accounts and, therefore, it could and should produce the evidence as to which accounts were paid. This is particularly true because after October 6th, 1932, the collections were never even sent to the bankrupt, but were made direct by petitioner. There is no presumption based on a presumption at all. The case shows a

fraudulent scheme on the part of the petitioner to hinder and delay creditors, which was duly carried out by its agent Bradley. Having created a condition through this fraudulent scheme, including the so-called reserve, and having so conducted the bankrupt's affairs that all other creditors were hindered, delayed and defrauded, petitioner is not in a position to claim that there is any presumption of fair dealing on its part.

The Trustee has established the fundamental facts and is merely asking that the petitioner make good a part of the loss to these creditors. More than $20,000 of new debts were created after July 1, 1932, which are entirely unpaid (R. 242, 245).

There are numerous cases to the effect that every single assignment made by the petitioner after July 1, 1942, is void and the Trustee would be entitled to recover the value of these accounts, regardless of the consideration paid by the petitioner. See the following cases:

In re Farm & Home Co.
84 Fed (2) 933.
Collier on Bankruptcy,
14th Ed., Vol. 4, p. 344.
Corpus Juris Secundum (*Bankruptcy*),
Sec. 240, p. 861.
Lowenstein v. Reikes,
60 Fed. (2d), 933.
Buffum v. Peter Barcelona Co.,
289 U. S. 227; 77 Law Ed. 1140.

The only other proposition presented by the petition is that this decision by the Court of Appeals would seriously affect the operations of financing companies which purchase accounts under the authority of the

Manufacturers' Finance Company v. McKey, 294 U. S. 442, 79 L. Ed., 982.

A careful reading of the opinion shows that this case does not in the slightest affect fair and legitimate financing. It simply holds that where a finance company has been guilty of entering into a fraudulent scheme resulting in delaying and hindering creditors that the burden is on such a creditor to show that payments made to it were legitimate. The decision is based on the peculiar facts of this case and have no bearing on the general principles of financing, other than it is a fair warning to such companies to treat their debtors and other creditors fairly and honestly. It simply holds that such companies convicted of obtaining a fraudulent preference must disclose the facts and information within their exclusive possession. Any finance company that acts and conducts itself according to the principles laid down in Manufacturers' Finance Company against McKay would have no trouble.

We, therefore, submit that the granting of this petition should be denied on the ground that this decision is not contrary to the decisions of other Circuit Courts of Appeal. This case is exactly in accordance with the cases of other Courts of Appeal and of this Court. The decision is not contrary to any decision in this Court, nor is it of vital or great importance to financial institutions that conduct their business on a proper basis.

In addition to that it is manifest that the merits of this case have been reached and there is no necessity or need to prolong this litigation.

We, therefore, submit that this petition should be denied.

Respectfully submitted,

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